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IN THE

Supreme Court of the United States

OCTOBER TERM 1952.

No. 210

DUVEEN BROTHERS, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

HUGH SATTERLEE,
ROLLIN BROWNE,
Counsel for Petitioner,
30 Broad Street,
New York 4, New York.

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No.....

DUVEEN BROTHERS, INC.,
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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioner prays that a writ of certiorari be issued to review the judgment (R. 33) of the United States Court of Appeals for the Second Circuit, affirming the decision of the Tax Court of the United States (R. 33).

OPINIONS BELOW

The majority opinion (R. 20) and the dissenting opinion (R. 28) of the Tax Court are reported in 17 T. C. 124. The *per curiam* opinion of the Court of Appeals (R. 31) is not yet reported.

JURISDICTION

Jurisdiction to issue the writ prayed for is vested in this Court by Section 1254 of Title 28 of the United States Code. The judgment of the Court of Appeals (R. 33) was entered on May 21, 1952.

QUESTION PRESENTED

Where after the realization of capital gain from the sale of stock, the taxpayer was required to make a payment to the purchasers under a warranty that the stock would not be redeemed before a specified amount of dividends had been paid thereon, was the loss resulting from the payment under the warranty a capital loss arising from the sale?

SUMMARY STATEMENT OF FACTS

In the tax years 1944 and 1945 the petitioner sold a number of shares of preferred stock of S. H. Kress & Company. The stock was redeemable at any time at a price less than the price at which it was being sold, but the petitioner warranted that it would not be redeemed before the purchasers had received dividends in an amount equal to the excess of the sale price over the redemption price.

In the tax year 1945, after all the sales had been made, the stock was redeemed and the petitioner made a substantial payment to the purchasers, in accordance with the terms of its warranty.

It is agreed that each sale of the stock was a "closed transaction" for tax purposes, on which the petitioner realized a capital gain equal to the excess over cost of the full amount received from the purchasers.

The Commissioner of Internal Revenue took the position that the later payment under the warranty was in effect a partial refund of the purchase price and therefore constituted a capital loss arising from the sales. Because of the limitation on the deductibility of capital losses (I. R. C., Sec. 117(d)), and since the gain from the petitioner's 1945 sale was not sufficient to absorb the loss under the warranty with respect to the 1944 sales, the result was that the petitioner was denied the full tax benefit from such loss, although it had been required to pay tax on the full gain which it had realized when the 1944 sales were made. In other words, as to the 1944 sales, the petitioner has been held to have realized a taxable gain in 1944 and also a non-deductible loss in 1945.

The Tax Court upheld the Commissioner, over four dissents. The Court of Appeals affirmed *per curiam*.

SPECIFICATIONS OF ERROR

The Court of Appeals erred:

1. In affirming the decision of the Tax Court.

2. In holding that the loss resulting from the petitioner's payment under its warranty was a capital loss arising from the sale of the stock.

3. In failing to hold that such loss was an ordinary loss fully deductible in computing the petitioner's net income, without regard to the limitation on the deductibility of capital losses.

REASONS FOR GRANTING THE WRIT

1. In its *per curiam* opinion, the Court of Appeals expressly based its affirmance of the Tax Court's decision on the authority of its decisions in *Commissioner* v. *Arrowsmith* (therein referred to as *Commissioner* v. *Bauer*), 193 F. 2d 734, and *Commissioner* v. *Milliken*, 196 F. 2d 135, in both of which cases it had expressly disapproved and refused to follow the decision of the Court of Appeals for the Third Circuit in *Commissioner* v. *Switlik*, 184 F. 2d 299, although recognizing that there was no basis for distinguishing that case. Because of the square conflict between the Second and Third Circuits, this Court has granted certiorari in *Commissioner* v. *Arrowsmith*, and that case is now pending on the docket of this Court, No. 51. Certiorari has been applied for in *Commissioner* v. *Milliken* (No. 185), and presumably will be granted.

The *Switlik*, *Arrowsmith* and *Milliken* cases all involved corporate liabilities incurred before liquidation which former stockholders were required to pay after liquidation as transferees of the corporate assets. The Third Circuit held that the resulting loss was not a capital loss arising from the prior exchange of the stock for corporate assets on liquidation. The Second Circuit held to the contrary. The petitioner contended below and here contends that since its liability arose out of an event which did not occur until after the stock had been sold, and was based on its own voluntary agreement, the loss sustained from satisfying such liability could not be considered a capital loss arising from the sale of the stock, even if a contrary decision should be reached as to a stockholder's transferee liability, arising at the instant the stock was disposed of, to satisfy a then-existing corporate debt. However, the Court below

refused to recognize any such distinction and, as stated, based its affirmance of the Tax Court's decision squarely on its own decisions in the *Arrowsmith* and *Milliken* cases.

The allowance of certiorari in the *Arrowsmith* case sufficiently demonstrates the importance of the basic question here involved and the propriety and necessity of a final decision thereon by this Court, in order to resolve the conflict between the Second and Third Circuits. The petitioner submits that it should be given an opportunity to be heard at the same time. The fundamental question of the dividing line between loss from the sale of capital assets and ordinary loss is involved in all these cases.

2. The liability which resulted in the losses in the *Arrowsmith* case arose under a judgment which had been entered against the dissolved corporation and also against one of its stockholders, Bauer, individually. Bauer claimed that even if it should be held that the satisfaction of a transferee liability results in a capital loss, the satisfaction of his individual liability under the judgment resulted in an ordinary loss. The Court of Appeals refused to recognize any such distinction between his individual liability and his liability as transferee, and the question of whether such a distinction should be recognized will be presented to this Court in that case. The distinction thus sought to be established in the *Arrowsmith* case as to the individual liability of Bauer is quite similar to the distinction which the petitioner seeks to establish as to its liability under its warranty, as referred to in the next preceding paragraph hereof.

In the *Milliken* case, although the liability which resulted in the loss was a stockholder's transferee liability, it is urged that there is stronger ground for holding that the loss resulting from satisfaction of the liability cannot be

considered to have arisen from the liquidation, because the liability of the liquidated corporation had not been asserted until after the liquidation. Since in the instant case the liability was based on an event which not only was not ascertained but actually did not occur until after the petitioner had disposed of the stock, it was even further removed from the original capital transaction than the liability in the *Milliken* case.

In view of the distinctions which are being urged in the *Arrowsmith* and *Milliken* cases, it is submitted that the petitioner herein should be given an opportunity to establish in this Court the validity of the somewhat similar though stronger distinction on which it alternatively relies.

It is, therefore, respectfully requested that a writ of certiorari be issued to review the judgment of the Court of Appeals in this case and that it be set down for argument immediately after the *Arrowsmith* case.

July 16, 1952.

Respectfully submitted,

Hugh Satterlee,
Rollin Browne,
Counsel for the Petitioner,
30 Broad Street,
New York 4, New York.

In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 210

DUVEEN BROTHERS, INC., *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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MEMORANDUM FOR THE RESPONDENT

This case presents the same question as No. 51, *Arrowsmith (Bauer Estate)* v. *Commissioner*, certiorari granted, June 9, 1952, 343 U.S. 976, namely whether a taxpayer who realizes a capital gain from the sale or exchange of a capital asset, and thereafter refunds a portion of the amount received in satisfaction of a liability which arises from the sale or exchange, may deduct the refund

payment as an ordinary loss under Section 23(e) or (f) of the Internal Revenue Code, or is required to treat the payment as a capital loss deductible only to the extent provided in Sections 23(g) and 117. In *Arrowsmith* the stockholders of a liquidated corporation refunded to a creditor of the corporation a portion of the amount received on the exchange of their stock for the corporate assets, in satisfaction of their transferee liability arising from the exchange by operation of law. In this case the seller of stock refunded to the purchaser a portion of the purchase price, in satisfaction of a guarantee liability arising from the contract of sale.[1]

The Tax Court sustained the Commissioner's determination that the payment was deductible as a capital rather than an ordinary loss (R. 25-28), and the court below affirmed *per curiam* on the authority of its decisions in the *Arrowsmith* case, 193 F. 2d 734, and in *Commissioner* v. *Milliken*,

[1] Taxpayer attempts (Pet. 4-6) to distinguish this case from *Arrowsmith* and others involving post-liquidation refunds by stockholders on the theory that there the liability to make the refund payments arose simultaneously with the exchange, whereas here it arose after the sale. As a matter of fact, in those cases as in this one, the liability was contingent at the time of the sale or exchange and became absolute afterward. In any event, whether the payment is deductible as an ordinary or capital loss turns on the nature of the liability which it satisfies. The important factor common to each case is that the payment satisfied a liability which was directly related to—and would not have existed but for—the sale or exchange.

196 F. 2d 135 (R. 31-32). A petition for a writ of certiorari has been filed in the *Milliken* case, No. 185, and in order that the decision in that case may conform to this Court's decision in *Arrowsmith* the Commissioner has not opposed the granting of the writ in that case, limited to the question common to both cases.[2] In order that this case may also be decided in conformity with this Court's decision in *Arrowsmith*, the Commissioner does not oppose certiorari in this case, and respectfully suggests that the Court may desire to withhold action upon the present petition pending its decision on the merits in the *Arrowsmith* case.[3]

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

AUGUST, 1952

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[2] Only one of the issues involved in the *Milliken* case is the same as that presented in *Arrowsmith*. Reference is made to the Commissioner's memorandum in response to the petition in the *Milliken* case, No. 185.

[3] We are informed that the *Arrowsmith* case has been set for argument in this Court during the week of October 20, 1952.

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IN THE

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OCTOBER TERM, 1952.

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v.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

The respondent, although not opposing the granting of a writ of certiorari in this case, "suggests that the Court may desire to withhold action upon the present petition pending its decision on the merits in" *Arrowsmith (Bauer Estate)* v. *Commissioner*, in which a writ of certiorari was granted on June 9, 1952.

It is respectfully submitted that on principle this petitioner is entitled to its day in court and to be heard when the broad question common to this case and the *Arrowsmith* case is presented to this Court.

Especially is this so since this case presents a variation of the question, the materiality of which otherwise may be determined, without benefit of argument, by what is decided in the *Arrowsmith* case.

August, 1952.

Respectfully submitted,

HUGH SATTERLEE
ROLLIN BROWNE
Counsel for the Petitioner.

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Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR RECONSIDERATION OF PETITION FOR WRIT OF CERTIORARI.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952.

No. 210.

DUVEEN BROTHERS, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR RECONSIDERATION OF PETITION FOR WRIT OF CERTIORARI.

The petitioner prays that the denial on November 17, 1952, of its petition for a writ of certiorari submitted on July 18, 1952, be reconsidered and that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit.

Because the Court of Appeals expressly based its decision in this case on the authority of its decision in *Commissioner* v. *Arrowsmith*, 193 F. (2d) 734, which was in conflict with the decision of the Court of Appeals for the Third Circuit in *Commissioner* v. *Switlik*, 184 F. (2d) 299, the petitioner chiefly stressed that reason for review and

believed it sufficient for assuring the petitioner the right to present its case.

If the Court had reversed the decision of the Court of Appeals in the *Arrowsmith* case, *a fortiori* its decision in this case would have required reversal. In view of the Court's affirmance of the *Arrowsmith* decision, it seems proper to point out fundamental differences between this case and the *Arrowsmith* case which provide adequate reasons for review.

1. In the *Arrowsmith* and *Switlik* cases and others following the *Switlik* decision the taxpayers received liquidation distributions the excess of which over the basis of their stock was treated as gain from the sale or exchange of a capital asset. But in each case the distribution was larger than it should have been because of the existence at the date of distribution of facts creating liabilities of the corporation for taxes or otherwise which diminished the distributable shares of the stockholders and if recognized before the distributions were made would have curtailed them. Because of their inherent liability as transferees the stockholders were required to pay back part of what they had received.

In the present *Duveen* case the petitioner over several years sold to bankers preferred stock of the Kress Company which the petitioner had accepted in payment for works of art. The sales prices exceeded the price at which the Kress Company might redeem the stock. In connection with the sales the petitioner guaranteed that before redemption dividends would be paid equal in amount to the difference between the redemption price and the selling price (R. p. 13). The Kress Company redeemed the stock six months after the last sale by the petitioner. On the stock first sold the dividends received satisfied the petitioner's

guaranty, but on stock later sold the dividends were insufficient and the petitioner paid the deficiencies, thereby suffering a loss.

A fair reading of the guaranty agreement establishes that the petitioner did not indemnify the purchasers of the stock against the capital loss which they would sustain if the stock were redeemed. On the contrary, whether the stock were redeemed six months or six years after the sale, if at all, the purchasers would inevitably sustain the same capital loss. All they required from the petitioner was an agreement assuring them ordinary income, whether through dividends or payments in lieu thereof by the petitioner, to the extent of the difference between the redemption price and the price they paid. The petitioner merely agreed that in the event of early redemption it would make up any deficiency in dividends and put the purchasers in the same position as if they had received them. But in all events the purchasers would be left to bear the full capital loss sustained on the redemption.

Two basic differences exist between the liquidation cases such as *Arrowsmith* and the present *Duveen* case. In the former the stockholders received more than they were legally entitled to at the time of distribution, because of the existence of facts unknown or unrecognized; and their transferee liability was to return what had been erroneously distributed to them. In the *Duveen* case the petitioner received only what it was entitled to, unaffected by any latent facts; and its liability subsequently arising was to make up, not the capital loss to the purchasers resulting from the fact of redemption, but a loss of dividends resulting merely from the time of redemption.

Thus, as a consequence of the sale of the stock, yet not proximately caused by the sale, but by the fortuitous early redemption of the stock, the petitioner sustained a loss not

within the exception relating to losses from the sale of capital assets. A corporation which sells stock of a subsidiary and guarantees the payment of dividends by the subsidiary, or a person who sells property subject to a lease and guarantees the payment of rent by the tenant, must realize an ordinary loss and not a capital loss in the event of default by the subsidiary or tenant in dividend or rental payments.

2. The Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

Until the decisions of the Court of Appeals in the *Arrowsmith* and *Duveen* cases no serious question had arisen that "loss from the sale of a capital asset" meant loss determined under §111(a) of the Code at the time of the sale by comparing the proceeds with the basis of the property sold. Once the sale was made and the gain or loss so determined, it was a closed transaction. The concept that the same sale which resulted in a capital gain could later result in a "loss from the sale of a capital asset", computed without reference to §111(a), seemed unlikely of acceptance in the light of the statutory provisions.

Section 23(f) provides that in computing net income there shall be allowed as deductions in the case of a corporation losses sustained during the taxable year and not compensated for by insurance or otherwise. This is the general rule and all losses by corporations are fully deductible unless specifically excepted. Section 23(g) provides that losses from sales or exchanges of capital assets shall be allowed only to the extent provided in Section 117, which prescribes special treatment for capital gains and losses from the sale or exchange of capital assets. Section 111(a) provides:

> "The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized."

No question was involved in the present case as to the adjusted basis of the Kress stock, which was the sum at which it was accepted in payment for sales of works of art. Under Section 111, therefore, the gain was the amount realized over the basis. To have incurred a loss from the sale there would have had to be an excess of the basis over the amount realized.

Now that this Court has in the *Arrowsmith* case decided that a loss from the sale of a capital asset may occur after the sale has been consummated and capital gain determined, the Commissioner of Internal Revenue is in a position to assert that every payment by a seller to a buyer after a sale, however indirectly connected with it, and although not constituting a partial refund of the sales price, constitutes a capital loss. In the public interest of avoidance of unnecessary litigation and of correct understanding of the tax statute, it is important that this Court state whether the principle of the *Arrowsmith* decision is to be limited to the return of part of the proceeds of sale or exchange pursuant to an obligation arising by law or by agreement out of the facts existing at the time of sale or exchange, or is to extend to a loss resulting from a payment subsequently made of a liability subsequently arising in satisfaction of a collateral guaranty, as in the *Duveen* case. Judge Frank in the first sentence of his *Arrowsmith* opinion, which the Court of Appeals regarded as applicable to the *Duveen* case, seems to have gone the whole way and

to have adopted for tax law the discredited "but for" theory of negligence law.

3. The decision of the Court of Appeals conflicts with the principle enunciated by this Court in *Dobson* v. *Commissioner*, 321 U. S. 231, as follows:

> "The weakness of taxpayers' position lies in the fact that not every gain growing out of a transaction concerning capital assets is allowed the benefits of the capital gains tax provision. Those are limited by definition to gains from 'the sale or exchange' of capital assets. Internal Revenue Code, §117(2), (3), (4), (5).
>
> We certainly cannot say that the items in question were as matter of law proceeds of the 'sale or exchange' of a capital asset. Harwick asserted a claim, and the three other taxpayers involved in these cases filed suit against the National City Company, demanding rescission of their purchases of stock. Their claims were compromised or admitted; the taxpayers seek to link the recoveries resulting therefrom with their prior sales of the stock, which resulted in losses. The Tax Court did not find as matter of fact, and we decline to say as matter of law, that such a transaction is a 'sale or exchange' of a capital asset in the accepted meaning of those terms."

4. The issue cuts deeper than the mere application of the annual accounting rule. Gain or loss from a sale arises when the sale is consummated—not prior or subsequently to the sale. If at the date of sale, of transfer of title and the receipt of the purchase price, no obligation exists, whether or not then recognized, to return part of the purchase price, the sale is a closed transaction. There is no more basic principle of tax law. If thereafter, in the same year or later, liability for a payment by the seller to the

buyer arises because of events occurring after the date of sale, such payment cannot be a loss from the sale.

The *Arrowsmith* case was apparently argued as governed solely by the annual accounting rule, since it was not denied that if the return of part of the distribution had occurred during the same taxable year it would have been treated as a capital loss reducing the previous capital gain. If so, the distribution was not a true closed transaction, which depends on substantive law and not on tax accounting.

It is submitted that because of its importance to the revenue and of its equal importance to taxpayers generally this Court should clarify its decision in the *Arrowsmith* case by ruling that it applies only to transactions incomplete because subject to existing liabilities, known or unknown, as in the *Arrowsmith* case, or that it extends to fully closed transactions accompanied by collateral agreements contingently affecting future income, as in the *Duveen* case. A guide to the scope of the exception from the general rule of "losses from the sale or exchange of capital assets" is vital to an orderly and sound administration of the tax law.

For the foregoing reasons it is respectfully urged that this petition for reconsideration of the petition for certiorari be granted and a writ of certiorari be issued to review the judgment of the Court of Appeals for the Second Circuit.

Respectfully submitted,

HUGH SATTERLEE,
ROLLIN BROWNE,
Counsel for the Petitioner.

Dated November 26, 1952.

CERTIFICATE.

I, HUGH SATTERLEE, counsel for the above-named petitioner, do hereby certify that the foregoing petition for reconsideration of the petition for writ of certiorari in this cause is presented in good faith and not for delay.

HUGH SATTERLEE,
Counsel for Petitioner.